(3)

No. 06-659

FILED

JAN 12 2007

OFFICE OF THE CLERK
SUPREME COURT, U.S.

IN THE

Supreme Court of the United States

COLTEC INDUSTRIES, INC.,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF *AMICI CURIAE* OF THE NATIONAL ASSOCIATION OF MANUFACTURERS AND THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF PETITIONER

JAN S. AMUNDSON
Senior Vice President & General Counsel
QUENTIN RIEGEL
Vice President & Deputy General Counsel
NATIONAL ASSOCIATION OF MANUFACTURERS
1331 Pennsylvania Avenue N.W.
Washington, D.C. 20004-1790
(202) 637-3000

ROBIN S. CONRAD
AMAR D. SARWAL
NATIONAL CHAMBER LITIGATION CENTER, INC.
1615 H Street, N.W.
Washington, D.C. 20062
(202) 463-5337

PETER B. RUTLEDGE
Counsel of Record
127 Moncure Drive
Alexandria, VA 22314
(202) 319-5140

Counsel for Amici Curiae

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. In determining that a transaction may be disregarded for tax purposes, should a federal court of appeals review the trial court's findings that the transaction had economic substance *de novo* (as three courts of appeals have held), or for clear error (as five courts of appeals have held)?

2. Where a taxpayer made a good-faith business judgment that the transaction served its economic interests, and would have executed the transaction regardless of the tax benefits, did the court of appeals (in acknowledged conflict with the rule of other circuits) properly deny the favorable tax treatment afforded by the Internal Revenue Code to the transaction based solely on the court's "objective" conclusion that a narrow part of the transaction lacked economic benefits for the taxpayer?

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF AUTHORITIES	v
INTEREST OF *AMICI CURIAE*	1
SUMMARY OF THE ARGUMENT	2
I. THE DECISION BELOW THWARTS LONGSTANDING AND IMPORTANT PRINCIPLES OF JUDICIAL DEFERENCE TO BUSINESS JUDGMENT	3
A. American Company Law Reflects A Tradition Of Deference To Business Judgment	3
B. The Federal Circuit's Economic Substance Analysis Undercuts This Tradition of Deference	4
1. The decision below sows confusion over the meaning of various judicially created doctrines governing the availability of deductions and credits under the Internal Revenue Code	4
2. The lower court's standard for economic substance determinations virtually guarantees judicial second-guessing of good-faith business judgments	7
3. The Federal Circuit's division of a transaction into discrete packages takes an unrealistic view of corporate governance and calls into doubt a variety of familiar, beneficial activities previously approved by this Court and others	9

TABLE OF CONTENTS—Continued

Page

4. This case presents a particularly appropriate vehicle for resolving these important questions 13

II. THE INTERCIRCUIT DISAGREEMENT OVER THE STANDARD OF REVIEW OF "ECONOMIC SUBSTANCE" DETERMINATIONS IS AN IMPORTANT ISSUE FOR AMERICA'S BUSINESS COMMUNITY 14

CONCLUSION 16

TABLE OF AUTHORITIES

CASES Page

ACM P'ship v. Commissioner, 157 F.3d 231 (3d Cir. 1998) 6
American Elec. Power Co., Inc. v. United States, 326 F.3d 737 (6th Cir. 2003) 15
Aronson v. Lewis, 473 A.2d 805 (Del. 1984) 4
Black & Decker Corp. v. United States, 436 F.3d 431 (4th Cir. 2006) 15
Brehm v. Eisner, 746 A.2d 244 (Del. 2000) 4
Cooper Indus., Inc. v. Leatherman Tool Group, Inc., 532 U.S. 424 (2001) 14
Cottage Sav. Ass'n v. Commissioner, 499 U.S. 554 (1991) 10
Daily Income Fund, Inc v. Fox, 464 U.S. 523 (1984) 3
Dow Chem. Co. v. United States, 435 F.3d 594 (6th Cir. 2006) 15
Frank Lyon Co. v. United States, 435 U.S. 561 (1978) 9
Grutter v. Bollinger, 539 U.S. 306 (2003) 5
Illinois Tool Works, Inc. v. Independent Ink, Inc., 126 S.Ct. 1281 (2006) 4
Jacobellis v. Ohio, 378 U.S. 184 (1964) 6
Keeler v. Commissioner, 243 F.3d 1212 (10th Cir. 2001) 15
Kumho Tire Co. v. Carmichael, 536 U.S. 137 (1999) 14
Northern Indiana Pub. Serv. Co. v. Commissioner, 115 F.3d 506 (7th Cir. 1997) 11
Rogers v. United States, 281 F.3d 1108 (10th Cir. 2002) 6
State Oil Co. v. Kahn, 522 U.S. 3 (1997) 4
Sutton v. United Airlines, Inc., 527 U.S. 471 (1999) 4

TABLE OF AUTHORITIES—Continued

Page

Texas Dep't of Community Affairs v. Burdine, 450 U.S. 248 (1981) 4
TIFD III-E, Inc. v. United States, 459 F.3d 220 (2d Cir. 2006) 15
United Parcel Serv. of Am., Inc. v. Commissioner, 254 F.3d 1014 (11th Cir. 2001)..... 15
Winn-Dixie Stores, Inc. v. Commissioner, 254 F.3d 1313 (11th Cir. 2001) 15

STATUTORY AUTHORITIES

U.C.C. Art. 1-301 4
U.C.C. Art. 2-201(2)..... 4
U.C.C. Art. 2-207(2)..... 4
11 U.S.C. §501 4

OTHER AUTHORITIES

Korb Acknowledges U.S. Supreme Court May Need to Clarify Economic Substance, Daily Tax Rep. (BNA) (Oct. 27, 2006)..... 6, 13
Joseph Bankman, *The Economic Substance Doctrine*, 74 S. Cal. L. Rev. 5 (2000)..... 6
Richard W. Duesenberg, *The Business Judgment Rule and Shareholder Derivative Suits: A View from the Inside*, 60 Wash U. L. Q. 311 (1982).. 4, 5
Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 Cornell L. Rev. 261 (1986)..... 5
David P. Hariton, *Sorting Out the Tangle of Economic Substance*, 52 Tax Law. 235 (1999) 6
I.R.S. Pub. 583, *Starting a Business and Keeping Records, available at* http://www.irs.gov/pub/irs-pdf/p583.pdf 12

TABLE OF AUTHORITIES—Continued

Page

I.R.S. Manual 31.1.1.1.3 (4), *available at* http://www.irs.gov/irm/part31/ch01s01.html).... 13

John F. Prusiecki, Coltec: *A Case of Misdirected Analysis of Economic Substance*, 112 Tax Notes 524 (Aug. 7, 2006) 9

Mark J. Silverman et al., *The Economic Substance Doctrine: Sorting Through the Federal Circuit's "We Know It When We See It" Ruling in* Coltec, Tax Executive 423 (Nov./Dec. 2006) 6, 9, 12

Sheryl Stratton, *Government, Tax Bar Disagree Over Impact of* Coltec, 212 Tax Notes 1 (Nov. 1, 2006)..... 6

Sheryl Stratton, *Korb Praises, Practitioners Question Enforcement Shift*, 113 Tax Notes 394 (Oct. 30, 2006)..... 13

Crystal Tandon & Sheryl Stratton, *Korb, Former IRS Officials Discuss Recent Shelter Cases*, 112 Tax Notes 1113 (Sept. 25, 2006)..... 10

U. S. Dep't of Commerce, Small Bus. Adm., 2006 Performance and Accountability Report .. 13

IN THE

Supreme Court of the United States

No. 06-659

COLTEC INDUSTRIES, INC.,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF *AMICI CURIAE* OF THE NATIONAL ASSOCIATION OF MANUFACTURERS AND THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF PETITIONER

INTEREST OF *AMICI CURIAE* [1]

The National Association of Manufacturers ("NAM") is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The NAM's mission is to enhance the

[1] Pursuant to Supreme Court Rule 37.6, *amici* state that the brief was authored in its entirety by *amici curiae* and their counsel. No monetary contribution toward the preparation or submission of this brief was made by any person other than *amici curiae*, their members and their counsel. By letters filed with the Clerk of the Court, petitioner and respondent have consented to the filing of this brief.

competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media and the general public about the vital role of manufacturing in America's economic future and living standards. In support of this mission, the NAM regularly files briefs *amicus curiae* in this Court and other courts.

The Chamber of Commerce of the United States of America ("Chamber") is the nation's largest federation of business companies and associations. It represents an underlying membership of more than three million business, trade and professional organizations of every size, sector and geographic region of the country. One of the Chamber's primary missions is to represent the interests of its members by filing *amicus curiae* briefs in cases involving issues of national importance to American business.

SUMMARY OF THE ARGUMENT

This Court should grant *certiorari* for two reasons, in addition to those given in Coltec's petition.

First, not only does the decision below fuel the intercircuit disagreements over the economic substance doctrine, the Federal Circuit's entire approach jeopardizes important principles of judicial deference to business judgment. Such deference reflects both a desire to facilitate efficient capital allocation and an awareness about the relative expertise of government officials and businesspeople. The decision below undermines this deep and important tradition of deference. It sows confusion over the relationship between the economic substance doctrine and other judicially created tax doctrines, virtually invites unpredictable judicial second-guessing of businesspersons' decisions and takes a wholly unrealistic view of business planning. Moreover, in light of the IRS's very public pronouncements about how it intends

to exploit the decision below, this Court's prompt intervention is necessary.

Second, the intercircuit disagreement over the standard of appellate review of "economic substance" determinations also presents an important issue for the business world. This Court routinely has granted *certiorari* to resolve disagreements over the proper standard of review and, thereby, to provide a uniform nationwide rule. In the specific context of economic substance determinations, the standard of review is especially important. The plenary review required by the court below exacerbates the lack of deference and effectively provides the Government an added and inappropriate tool in its litigation against American businesses.

ARGUMENT

I. THE DECISION BELOW THWARTS LONG-STANDING AND IMPORTANT PRINCIPLES OF JUDICIAL DEFERENCE TO BUSINESS JUDGMENT.

A. American Company Law Reflects A Tradition Of Deference To Business Judgment.

It is a "basic principle of corporate governance that the decisions of a corporation . . . should be made by the board of directors or a majority of the shareholders." *Daily Income Fund, Inc v. Fox*, 464 U.S. 523, 530 (1984). Stripped to its essence, this case concerns whether courts will defer to those judgments or second-guess them by employing a wholly unpredictable test.

Several legal doctrines exemplify a long tradition of judicial deference to business judgment. Perhaps the most familiar is the business judgment rule in corporate law, which creates "a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the

best interests of the company." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). Accordingly, good-faith business decisions "will not be disturbed if they can be attributed to any rational business purpose." *Brehm v. Eisner*, 746 A.2d 244, 264 & n. 65 (Del. 2000).

Outside the familiar field of corporate governance, other examples abound. For example, in employment law, courts defer to the legitimate business explanations for an employer's treatment of a present or prospective employee. *See, e.g., Sutton v. United Airlines, Inc.*, 527 U.S. 471, 493-494 (1999); *Texas Dep't of Community Affairs v. Burdine*, 450 U.S. 248 (1981). In commercial law, courts do not question the certain choices made in contracts "between merchants." *See, e.g.,* U.C.C. Art. 1-301, 2-201(2), 2-207(2). An entire chapter of the Bankruptcy Code is dedicated to the proposition that companies experiencing difficult—but ultimately surmountable—financial hardship are better left in the "possession" of the debtor rather than the government. *See* 11 U.S.C. §§501 *et. seq.* In antitrust law, this Court's shift away from *per se* rules and toward a "rule of reason" analysis reflects greater judicial acceptance of business judgment about the economic rationale for a transaction. *See, e.g., Illinois Tool Works, Inc. v. Independent Ink, Inc.*, 126 S.Ct. 1281 (2006); *State Oil Co. v. Kahn*, 522 U.S. 3 (1997).

These deferential doctrines reflect two underlying principles. First, excessive governmental intrusion into business affairs chills commercial activity. *See* Richard W. Duesenberg, *The Business Judgment Rule and Shareholder Derivative Suits: A View from the Inside*, 60 Wash U. L. Q. 311, 314 (1982). Governmental scrutiny of good-faith business activity increases its costs. Furthermore, if companies perceive that such scrutiny is likely, they may choose to abandon an undertaking altogether rather than risk costly and time-consuming governmental second-guessing.

Second, business executives are better suited to determine which transactions serve a company's interests. *Cf. Grutter v. Bollinger*, 539 U.S. 306, 328 (2003) (deferring to university's determination that diversity was "essential to its educational mission"). Government officials do not face the same choices as American businesspersons. *See* Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 Cornell L. Rev. 261, 273 (1986) ("A manager who makes bad business decisions is likely to have his wealth reduced or be fired; judges who make bad business decisions will continue in office with the same salary as before."); Duesenberg, 60 Wash. U. L. Q. at 314. They are not accountable to shareholders. They do not compete in a marketplace. Under immunity doctrines, rarely must they worry about liability for their actions. By contrast each of these considerations—shareholder satisfaction, market competition and liability management—is of paramount importance to the American business executive.

B. The Federal Circuit's Economic Substance Analysis Undercuts This Tradition of Deference.

In three respects, the decision below undercuts the above-described tradition of deference in American business law.

1. *The decision below sows confusion over the meaning of various judicially created doctrines governing the availability of deductions and credits under the Internal Revenue Code.*

A taxpayer who satisfies all of the technical requirements for a deduction or credit under the Internal Revenue Code does not necessarily receive that benefit. Instead, not only must the taxpayer satisfy the requirements set forth by Congress, it must also satisfy the requirements of certain judicially created doctrines such as the "substance over form"

doctrine, the sham-transaction doctrine, the business purpose requirement and the economic substance doctrine. *See* Joseph Bankman, *The Economic Substance Doctrine*, 74 S. Cal. L. Rev. 5, 12 (2000).

Even assuming their validity in a post-*Erie* world, these judicially created doctrines at least should be clear. The decision below deprives these doctrines of that essential clarity. Whereas some courts have treated doctrines such as "economic substance" and "substance over form" as separate concepts with distinct and identifiable requirements, *see, e.g., Rogers v. United States*, 281 F.3d 1108, 1113-16 (10th Cir. 2002), the court below treats them almost interchangeably, akin to some sort of general "equity" exception under the Internal Revenue Code. (Pet. App. 18a).

This latter approach has sowed confusion within the business community. *See generally* David P. Hariton, *Sorting Out the Tangle of Economic Substance*, 52 Tax Law. 235, 241 (1999) ("Much confusion has been engendered, however, by the fact that the courts have sometimes failed to address lack of economic substance as a requirement separate and apart from lack of business purpose."). It deprives the business community of any clarity over the meaning of these judicially created doctrines and their requirements. Tax advisors cannot realistically offer a confident opinion about the tax treatment of a particular transaction, and, ultimately, the businesspersons advised by them lack the confidence about a transaction's consequences for the company's bottom line.

As one judge has observed, the approach exemplified by the Federal Circuit's decision amounts to little more than a "smell test" under which courts can deny favorable tax treatment to transactions that they just don't like or, worse, don't understand. *ACM P'ship v. Commissioner*, 157 F.3d 231, 265 (3d Cir. 1998) (McKee, J., dissenting). Just as such amorphous tests chill desirable speech in the First Amendment context, *cf. Jacobellis v. Ohio*, 378 U.S. 184, 197

(1964) (Stewart, J., concurring), so too does the Federal Circuit's "I know it when I see it" test risk chilling corporate actions that may be in a company's best interest, *see infra* Part I.B.3. *See* Mark J. Silverman et al., *The Economic Substance Doctrine: Sorting Through the Federal Circuit's "We Know It When We See It" Ruling in* Coltec, Tax Executive 423 (Nov.-Dec. 2006). Rather than risk the expense and burden of litigating a transaction, a company may simply abandon it.

The typical duration of major business tax litigation makes the chilling effects of this "smell test" especially nefarious. In this case, for example, the appellate court issued its decision nearly ten years after Coltec reported the capital loss giving rise to the contested deduction. (Pet. App. 1a). The Federal Circuit's "equitable" approach thereby gives courts virtually unbounded latitude to apply the particular economic or political theories in vogue—years, or even decades, after the relevant business decisions were made.

At the threshold, therefore, this Court's intervention is necessary to decide the important and unresolved issue—further unsettled by the decision below—about the common-law power of courts to deny favorable tax treatment to transactions that satisfy the requirements set forth by Congress in the Internal Revenue Code.

2. *The lower court's standard for economic substance determinations virtually guarantees judicial second-guessing of good-faith business judgments.*

Coltec's petition ably demonstrates the intercircuit conflict over the proper test for economic substance determinations, a conflict that both commentators and the IRS's chief counsel have acknowledged. Sheryl Stratton, *Government, Tax Bar Disagree Over Impact of* Coltec, 212 Tax Notes 1 (Nov. 1, 2006); *Korb Acknowledges U.S. Supreme Court May Need to*

Clarify Economic Substance, Daily Tax Rep. (BNA) (Oct. 27, 2006). While that confusion itself supplies a reason for granting *certiorari*, the importance of the issue provides an additional reason justifying review.

The upshot of the Federal Circuit's "objective" test is that it simply ignores—indeed renders legally irrelevant—the actual reasons motivating a business executive's decision to undertake a transaction. Here is the critical portion of the opinion:

> [E]conomic substance is measured from an objective, reasonable viewpoint, not by the subjective views of the taxpayer's corporate officers. (Pet. App. 31a).

This judicial disdain for the economic judgments of American business executives undermines the above-described tradition of deference and carries all the perils of such judicial second-guessing—both the drag on economic activity and the risk of error. *See supra* Part I.A. In its opinion, the Federal Circuit quoted at length from the testimony of Coltec executives recounting the multiple reasons why they chose to create the Garrison subsidiary—to signal to the investment community that Coltec had a grip on its potential asbestos liabilities, to focus management and administration of these liabilities in a single unit, to reduce the risk of veil piercing claims against the parent company, and to make the company a potentially attractive target for a corporate merger. (Pet. App. 28a-29a, 31a). The Federal Circuit then declared that these actual subjective judgments are *wholly irrelevant* to its analysis. (Pet. App. 31a). Having cast the actual motives to one side, the only option left to a court under the Federal Circuit's test is to undertake its own fresh economic analysis of the transaction.

That is precisely what the Federal Circuit did here. At bottom, the Court's opinion rests on the belief that Coltec could have accomplished its desired business objective in a different (and less economically beneficial) way, so its

chosen course must lack economic substance. (Pet. App. 33a). Not only does this judicial second-guessing conflict with the deferential approach taken by this Court in *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978), *see* Pet. at 18-19, it also is fraught with risks. Apart from the lack of deference, there is a real risk that the court might get the economic analysis wrong. As a matter of tax law, several critics have demonstrated that the Federal Circuit committed just such an error in this case: it failed to explain how Coltec's very real contingent liabilities ultimately would be treated under the Internal Revenue Code. *See generally* John F. Prusiecki, Coltec: *A Case of Misdirected Analysis of Economic Substance*, 112 Tax Notes 524 (Aug. 7, 2006) (criticizing Federal Circuit's economic analysis); Silverman, Tax Executive at 432 (same). As a matter of corporate governance, the success of the Coltec executives' strategy betrays the flaws in the Federal Circuit's opinion: a major company ultimately bought Coltec after it had implemented the very plan criticized by the court below. (Pet. App. 59a).

3. *The Federal Circuit's division of a transaction into discrete packages takes an unrealistic view of corporate governance and calls into doubt a variety of familiar, beneficial activities previously approved by this Court and others.*

The other important—and erroneous—feature of the Federal Circuit's economic substance analysis is its division of the transaction into discrete steps, analyzing each separately rather than the transaction as a whole. This approach presents several problems.

For one thing, it takes a wholly unrealistic view of business planning. As any corporate executive or corporate counsel knows, transactions may proceed in multiple steps, but ultimately a unified corporate strategy connects them. Almost invariably, some step will be motivated in part—if not

wholly—by the tax consequences. *See* Prusiecki, 112 Tax Notes at 524 ("[A]ny transaction that involves any tax planning at all has one or more aspects or elements that are tax motivated and serve no nontax purposes."); Silverman, Tax Executive at 436 ("The potentially expansive reach of the economic substance test articulated in [the decision below] combined with the application of that test on a step-by-step basis raises questions with respect to virtually all tax planning . . . ."). By separating the transaction into discrete parts, the Federal Circuit's decision marks, according to several tax practitioners, a "troubling shift" that ignores the realities of business planning. Crystal Tandon & Sheryl Stratton, *Korb, Former IRS Officials Discuss Recent Shelter Cases*, 112 Tax Notes 1113 (Sept. 25, 2006).

For another thing, the logic of the decision below calls into doubt a variety of business actions motivated by a mixture of tax and non-tax considerations, including ones previously approved by this Court and others:

- *Mortgage Swaps*: In *Cottage Savings Association v. Commissioner*, this Court considered the tax treatment of mortgage swaps. 499 U.S. 554 (1991). These transactions were precipitated by the declining value of long-term, low-interest mortgages held by savings and loan institutions. Because federal banking laws at that time allowed them to swap mortgages without taking losses for regulatory accounting purposes, financial institutions swapped their mortgages in order to claim tax losses reflecting the difference between the high face value of the mortgages and their low fair market value at the time of the swaps. This Court held that the swaps qualified for the deduction and rejected the Government's argument to disallow them under the economic substance doctrine. *Id.* at 567-68. The Federal Circuit, however, would have disallowed the deduction. From an objective economic perspective, the swap worked no difference in the company's balance sheet—the original bundle of mortgages was

"substantially identical" to the swapped ones and had the same fair market value. *Id.* at 557. Thus, there was no objective economic explanation apart from the resulting tax benefits. The Federal Circuit's rule might well have deterred such swaps altogether, forcing financial institutions to carry large losses on their balance sheets without the opportunity to realize those losses.

- *Foreign Lending Subsidiaries and NIPSCO*: In the 1980's, American companies encountered difficulty raising capital domestically due to high interest rates. To ameliorate this problem, they established foreign subsidiaries which could raise money from foreign markets with lower interest rates and then lend that money to the domestic parent, with a repayment schedule tied to the foreign subsidiaries' obligations to its bond holders. The situs of those foreign subsidiaries was closely tied to the tax consequences: by locating the foreign subsidiary in a country that had a bilateral tax treaty with the United States, the domestic parent could utilize provisions relieving it of the obligation to pay withholding taxes on interest payments to the foreign subsidiary. The Seventh Circuit expressly approved this design (and the resulting favorable tax benefits), *see Northern Indiana Pub. Serv. Co. ("NIPSCO") v. Commissioner*, 115 F.3d 506 (1997), but it would fail under the Federal Circuit's rule. Under the logic of the Federal Circuit's decision, the choice to establish the foreign subsidiary would be decoupled from the choice where to locate it. While the establishment of the foreign subsidiary might have a non-tax economic explanation, the choice of location would not. It would be solely driven by the tax benefits inuring to the domestic parent from the tax treaty. Thus, if it had analyzed the facts of *NIPSCO*, the Federal Circuit would have disallowed the withholding benefit and, ultimately, increased the cost of capital to the domestic parent.

- *Choice of Corporate Form*: Businesses may take a variety of forms ranging from sole proprietorships to partnerships to corporations. While non-tax considerations may influence part of the decision, other parts of the decision may be influenced entirely by tax considerations. For example, a business may choose to adopt a corporate form, rather than a partnership, to take advantage of liability limitations. Yet tax considerations may drive entirely the choice between forms of corporation. Indeed, one of the IRS's own publications recognizes that "[a]n eligible domestic corporation *can avoid double taxation* (once to the corporation and again to the shareholders) by electing to be treated as an S-corporation." I.R.S. Pub. 583, *Starting a Business and Keeping Records* at 3, *available at* http://www.irs.gov/pub/irs-pdf/p583.pdf (emphasis added). Yet under the Federal Circuit's logic, the IRS would be giving bad advice: A court would have to bifurcate the "transaction" into two parts—(1) the choice to incorporate and (2) the choice of corporate form. While the former would have an objective economic justification, the latter would not. Consequently, a company opting for S-corporation status would not receive the favorable tax benefit.

In sum, each of these examples demonstrates how the Federal Circuit's approach—disaggregating transactions into separate steps and requiring an "objective non-tax" economic explanation for the step giving rise to the tax benefit—is simply incompatible with existing precedent and, if uncorrected, could have a damaging effect on economic activity. *See generally* Silverman, Tax Executive at 432-36 (describing several additional transactions whose tax treatment is potentially affected by Federal Circuit's analysis).

4. *This case presents a particularly appropriate vehicle for resolving these important questions.*

For two reasons, this Court needs to correct promptly the flawed economic substance analysis in the decision below.

First, the Federal Circuit is a court of nationwide jurisdiction. Unlike a regional appellate court, the Federal Circuit's decision has the potential to cast a wider precedential net in any case governed by its precedents. *See* Stratton, 212 Tax Notes 1.

Second, the IRS itself has signaled that it intends to rely heavily on that decision in its tax litigation. Just recently, the IRS's chief counsel heralded the case as one whose principles "will be cited 20 years from now" and will be of "wide use" to the IRS. Sheryl Stratton, *Korb Praises, Practitioners Question Enforcement Shift*, 113 Tax Notes 394 (Oct. 30, 2006); *Korb Acknowledges U.S. Supreme Court May Need to Clarify Economic Substance*, Daily Tax Rep. (BNA) (Oct. 27, 2006). In light of the IRS's expected use of this decision, timely correction is imperative.

Prompt correction is particularly important given the nature of business planning. In many cases, taxpayers reach settlements with the IRS before a case ever reaches trial (much less final judgment). *See* I.R.S. Manual 31.1.1.1.3 (4), *available at* http://www.irs.gov/irm/part31/ch01s01. html). Moreover, risk-averse companies may well abandon transactions altogether for fear of running afoul of the Federal Circuit's "smell" test and risking litigation with the IRS. While large companies perhaps can litigate these cases to judgment and through appeal, smaller businesses, which form the backbone of the American economy, do not have the luxury—or the legal budgets—to afford such a course. *See* U. S. Dep't of Commerce, Small Bus. Adm., 2006 Performance and Accountability Report, Executive Summary at

4 (noting that small businesses represent 99.7% of all employer firms, employ half of all private sector employees and have generated 60-80% of net new jobs annually over the last decade), *available at* http://www.sba.gov/idc/groups/public/documents/sba_homepage/03_summary.pdf.).

Thus, in addition to the reasons given in Coltec's petition, this Court should grant *certiorari* to address the important issues raised by—and to correct the deep flaws contained in —the Federal Circuit's economic substance analysis.

II. THE INTERCIRCUIT DISAGREEMENT OVER THE STANDARD OF REVIEW OF "ECONOMIC SUBSTANCE" DETERMINATIONS IS AN IMPORTANT ISSUE FOR AMERICA'S BUSINESS COMMUNITY.

Standards of review are important. They determine the level of deference that an appellate tribunal affords to trial courts. Thus, this Court has routinely granted review in cases about the proper standard of review. These include ones of special importance to the business community. *See, e.g., Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424 (2001); *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137 (1999).

This case too presents a question about the standard of review warranting *certiorari*. *Amici* agree with Coltec that *certiorari* is warranted to resolve a mature split among the federal appellate courts on the issue. (Pet. 14-15). Additionally, the issue is important to the business community for two reasons.

First, appellate courts have been aggressive in making *de novo* determinations that transactions lack economic substance (or otherwise fail under similar doctrines) despite the fact-intensive nature of that inquiry. In several recent cases, including the decision below, the *de novo* standard has been

utilized to upset favorable rulings that taxpaying corporations obtained at the trial level. *See, e.g., TIFD III-E, Inc. v. United States*, 459 F.3d 220, 230-31 (2d Cir. 2006); *Dow Chem. Co., v. United States*, 435 F.3d 594 (6th Cir. 2006), petition for *certiorari* filed, No. 06-478 (Oct. 4, 2006). By contrast, in recent cases when the taxpayers lost in the trial court, plenary review of an "economic substance" or similar determination generally did not benefit them on appeal—the appellate court found in the Government's favor. *See, e.g., American Elec. Power Co., Inc. v. United States*, 326 F.3d 737, 741 (6th Cir. 2003); *Winn-Dixie Stores, Inc. v. Commissioner*, 254 F.3d 1313, 1315 (11th Cir. 2001); *Keeler v. Commissioner*, 243 F.3d 1212, 1217 (10th Cir. 2001). *But see United Parcel Serv. of Am., Inc. v. Commissioner*, 254 F.3d 1014, 1017 (11th Cir. 2001). The consistent tendency of appellate courts —farther removed from the evidence and testimony—to find no economic substance in business transactions suggests that the standard of review is not neutral in operation.

Second, economic substance cases are increasingly reaching the federal appellate courts. As late as the 1990's, commentators bemoaned the paucity of reported decisions on the doctrine. *See* Hariton, 52 Tax Law. 235. Since 2000, however, there have been thirteen reported appellate decisions on the subject, including four in the last year alone. *See* Pet. App. 1a-33a; *TIFD III-E, Inc.*, 459 F.3d 220; *Black & Decker Corp. v. United States*, 436 F.3d 431 (4th Cir. 2006); *Dow Chem. Co.*, 435 F.3d 594. Thus, the issue can only be expected to grow in importance.

CONCLUSION

For the foregoing reasons, the Court should grant the petition for a writ of *certiorari*.

Respectfully submitted,

JAN S. AMUNDSON
Senior Vice President & General Counsel
QUENTIN RIEGEL
Vice President & Deputy General Counsel
NATIONAL ASSOCIATION OF MANUFACTURERS
1331 Pennsylvania Avenue N.W.
Washington, D.C. 20004-1790
(202) 637-3000

ROBIN S. CONRAD
AMAR D. SARWAL
NATIONAL CHAMBER LITIGATION CENTER, INC.
1615 H Street, N.W.
Washington, D.C. 20062
(202) 463-5337

PETER B. RUTLEDGE
Counsel of Record
127 Moncure Drive
Alexandria, VA 22314
(202) 319-5140

Counsel for Amici Curiae National Association of Manufacturers and the Chamber of Commerce of the United States of America

January 12, 2007